IN THE

Supreme Court of the United States

OCTOBER TERM, 1939.

No. 63.

V. L. LETULLE, *Petitioner*,

v.

FRANK SCOFIELD, UNITED STATES COLLECTOR OF INTERNAL REVENUE FOR THE FIRST DISTRICT OF TEXAS.

On Writ of Certiorari to the United States Circuit Court of Appeals for the Fifth Circuit.

REPLY BRIEF FOR PETITIONER.

W. E. DAVANT,
HOMER L. BRUCE,
Attorneys for Petitioner.

PRESS OF BYRON S. ADAMS, WASHINGTON, D. C.

INDEX.

CITATIONS.

Cases:

IN THE

Supreme Court of the United States

OCTOBER TERM, 1939.

No. 63.

V. L. LETULLE, *Petitioner*,

v.

FRANK SCOFIELD, UNITED STATES COLLECTOR OF INTERNAL REVENUE FOR THE FIRST DISTRICT OF TEXAS.

On Writ of Certiorari to the United States Circuit Court of Appeals for the Fifth Circuit.

REPLY BRIEF FOR PETITIONER.

PRELIMINARY STATEMENT.

Petitioner has fully stated the case in his brief in support of his petition for writ of certiorari and in his reply brief to respondent's brief in opposition to his petition. This brief is in reply to the brief filed by respondent on the merits.

SUMMARY OF ARGUMENT.

I.

The Circuit Court of Appeals was not authorized to reverse the District Court on the grounds set forth in its opinion, as those were in the nature of a defense by way of confession and avoidance which respondent was required to, but did not plead. Even if they were properly raised, the lower court erred in even considering them and in reversing the case.

II.

Respondent, not having appealed from the Circuit Court of Appeals, may not raise in this court the issue as to whether the transaction between the Irrigation Company and the Water Company was a tax free reorganization or not. Even if that question were properly before this Court, it must be decided against respondent, as a transfer by one corporation of substantially all its properties to another for the latter's bonds is a tax free reorganization.

ARGUMENT.

I.

The Lower Court Erred in Its Reversal as (a) the Point Decided by It Was Not Properly Raised by Respondent and (b) the Record Did Not Justify that Court's Action.

In order that there may be no question as to the holding of the Circuit Court of Appeals we quote the following pertinent part of its opinion (R. 287):

> "The evidence thus plainly shows that a large part of the property conveyed under the contract of Nov. 4, 1931, was not at that date owned by the Irrigation Company but by LeTulle, and that he conveyed it to his company by the device above stated *in order to transfer it to the purchaser along with the property of the Irrigation Company.* The statute makes no provision for the 'reorganization' of an individual. The

"plan of reorganization' which the Irrigation Company and LeTulle signed with the Water Company operated as a reorganization of the Irrigation Company, *but the property of LeTulle which was embraced in it was simply sold by him.* Using the Irrigation Company as a conduit for passing the title does not alter the substance of the matter. Only so much of the consideration as represents the price of the properties and business of the Irrigation Company is entitled to be protected from taxation as arising from a reorganization."

The Court accordingly reversed the case

"that further proceedings may be had consistent herewith."

That language of the Court is perfectly clear. It means that as to LeTulle's properties, they *were simply sold by him direct to the Water Company.* In other words the Court struck down and wholly disregarded the transfer by him to the Irrigation Company and its subsequent conveyance to the Water Company. The parallel with *General Utilities Co.* v. *Helvering,* 296 U. S. 200, is inescapable. There the Utilities Company distributed to its stockholders, after already negotiating a sale for them, certain stock in another company as a dividend. The stockholders then carried out the prearranged sale. The Board of Tax Appeals holding against the Commissioner, he appealed on the ground that the company by declaring the dividend thereby sold the stock and made a profit. The Circuit Court of Appeals overruled this contention, and then on its own motion disregarded the dividend and the sale by the stockholders and held the sale by the stockholders was a sale by the company. This Court held the lower court had no authority to consider the point as not properly raised. How then could the lower court here wholly disregard LeTulle's conveyance to the Irrigation Company and its transfer to the Water Company when the only contention respondent

ever made was that bonds are not securities and for that reason alone the transaction was not a tax free reorganization?

We desire a brief word in reference to the lower court's remark that "The statute makes no provision for the 'reorganization' of an individual," and respondent's argument to the same point. LeTulle transferred his properties to the Irrigation Company for stock under Section 112 (b) (5) of the Revenue Act of 1928 and not under any reorganization provision, the transfer being to a corporation of which he owned 100 per cent of the stock.

As to respondent's repeated inferences that LeTulle did not actually transfer his properties to the Irrigation Company but conveyed them directly to the Water Company, we respectfully refer to our brief in reply to respondent's brief in opposition, in which we demonstrate the fallacy of such statements.

Helvering v. *Bashford*, 302 U. S. 454, and *Bassick* v. *Commissioner*, 85 F. (2d) 8, are beside the point. In the *Bashford* case there was a complicated designed plan whereby certain stocks were passed through the Atlas Powder Company, which under the very plan itself it was required contemporaneously to pass on to another company, the whole purpose being to attempt to make Atlas a party to the re-organization and thereby allow the old stockholders of Union, Peerless and Black Diamond to get stock in Atlas free of taxes. In the *Bassick* case the whole question depended on whether Bassick and his associates owned 80 per cent of the stock of Bassick-Alemite Company. They did own 100 per cent temporarily but under the plan they were obligated immediately to convey to others enough to reduce their holdings to 41 per cent, and the court properly held they did not have the necessary "control".

Those and similar cases might be applicable in a contest on LeTulle's transfer of his properties to his Irrigation Company if he had been under contract to sell the stock he received, but that is not the case and that transaction never has been, and could not successfully be, questioned.

Here the Water Company desired to take over this whole irrigation project, whether owned by the Irrigation Company or LeTulle. Neither part was sufficient without the other. The agreement between the Irrigation Company and the Water Company made no reference as to how the Irrigation Company should acquire LeTulle's properties. He could have transferred them to his company for nothing as a capital contribution, sold them for cash or notes, or, as he did, transfer them for stock. As between the two companies and as far as the plan of reorganization was concerned, the method was immaterial.

The Irrigation Company acquired them and, when it executed the deed to the Water Company, it owned them in their entirety. Section 112(i)(1)(A) says that a reorganization includes "the acquisition by one corporation of • • • substantially all the properties of another corporation." When the conveyance was made, the Irrigation Company owned the properties. The statute does not say that it must have owned every one of them at the time the plan of reorganization was executed.

There was nothing but the utmost good faith. The whole transaction was carried out in a business way and for good business reasons. There was no scheming to get around the tax statutes as was done in the *Gregory*, *Bashford* and *Bassick* cases.

The statute was complied with, and for a court to deny its plain and unequivocal effect not only must there be found a far more fatal device than can possibly exist in this case but the government must let the taxpayer know that it intends to go outside the statute by pleading the device that it claims removes the taxpayer from the protection plainly given by the statute itself.

Such a defense is one by way of confession and avoidance —confessing that the legal requirements of the statute were complied with but its effect should be avoided because of the alleged device. Matters in confession and avoidance must always be pleaded affirmatively by the party relying

thereon. *General Utilities Co.* v. *Helvering, supra; Budd* v. *Commissioner*, 83 F. (2d) 509, 512; *Marshall* v. *Commissioner*, 57 F. (2d) 633, 634; *Commissioner* v. *Neaves*, 81 F. (2d) 947, 948-9.

In this case the Irrigation Company and LeTulle filed their income tax returns on the basis that he had conveyed these properties to the Irrigation Company for stock on a tax free basis (Section 112(b)(5)) and that the Irrigation Company had transferred them with its other properties to the Water Company for bonds in a tax free reorganization. The Commissioner accepted the returns on that basis—that is, that the Irrigation Company owned the individual properties and transferred them to the Water Company—and the only change that he made was to treat the latter transfer as taxable solely on the ground that bonds were not securities. In the District Court and in the Circuit Court of Appeals the government followed the same course, treating the properties as belonging to the Irrigation Company and seeking to sustain the tax that was levied against the Irrigation Company on the theory that it had made a taxable profit when it sold these same properties. The government collected the tax from LeTulle as transferee that it levied on the Irrigation Company on the profit it claimed that company made out of these very properties. In view of this record we submit that it is entirely too late for the government now to swap horses, at the instance and suggestion of the Circuit Court of Appeals, and now claim the right to break the transaction down into two parts, one a tax free reorganization and the other a sale by LeTulle to the Water Company.

Incidentally if such a position were tenable—and we submit it is not—then there would still be no tax on the Irrigation Company as its transfer was held by the Circuit Court of Appeals to be tax free and petitioner would still be entitled to recover the corporation tax that he paid as transferee.

II.

Respondent, Not Having Appealed to this Court, May Not Raise the Issue as to Whether the Reorganization Was Tax Free. Even if Properly Before this Court, it is Well Settled that it was a Non-Taxable Reorganization.

In spite of the fact that respondent has not appealed, he in part II of his brief seeks to relitigate in this Court the issue decided against him by both courts below that the transfer by the Irrigation Company to the Water Company was not a tax free reorganization because only bonds were involved and no stock. The Circuit Court of Appeals directly held that it was a tax free reorganization, and in the absence of an appeal by respondent, he is in no position to raise this issue in this court. *Helvering* v. *Pfeiffer*, 302 U. S. 247; *Federal Trade Commission* v. *Pacific States Paper Trade Association*, 273 U. S. 52; *Bothwell* v. *United States*, 254 U. S. 231; *Peoria & Pekin Union Ry. Co.* v. *U. S.*, 263 U. S. 528; *Bolles* v. *Outing Company*, 175 U. S. 262; *Alexander* v. *Cosden Pipe Line Company*, 290 U. S. 484; *Morley Construction Co.* v. *Maryland Casualty Co.*, 300 U. S. 185; *U. S.* v. *American Railway Express Co.*, 265 U. S. 425; *Landram* v. *Jordan*, 203 U. S. 56.

However, this question has long been definitely settled. The Irrigation Company transferred substantially all of its properties to the Water Company for $50,000 cash and $750,000 of long term bonds. This came within Section 112(i)(1)(A) defining a reorganization as including "the acquisition by one corporation of * * * substantially all the properties of another corporation." Section 112(b)(4) provides that no gain or loss shall be recognized if a corporation a party to a reorganization exchanges property for "stock *or* securities" of another corporation. The statute uses the word "or" and not "and", and clearly means that the Irrigation Company could receive either stock or securities or both, and no gain would be recognized.

Such was the Treasury Department's construction of prior similar statutes. Regulations 62, Art. 1556, under 1921 Revenue Act, and similar regulations under all subsequent acts; Cumulative Bulletin III-2 p. 26 (1924); Cumulative Bulletin III-2 p. 34; Cumulative Bulletin V-1 p. 10 (1926); Cumulative Bulletin V-2 p. 11; *Williams* v. *Commissioner*, 15 B. T. A. 227 (1929); *First National Bank* v. *Commissioner*, 21 B. T. A. 415 (1930).

In its decisions in December, 1935, this Court affirmatively settled the question. *Helvering* v. *Minnesota Tea Co.*, 296 U. S. 378; *Nelson Co.* v. *Helvering*, 296 U. S. 374; and *Helvering* v. *Watts*, 296 U. S. 387, in which last case this Court held that bonds were securities within the meaning of the act.

Since those decisions the Board of Tax Appeals and the Circuit Courts of Appeal have all held that an exchange of properties for bonds is a tax free reorganization even though no stock is involved. *Carl B. Segall* v. *Commissioner*, 38 B. T. A. 43; *Kaspare Cohn Co.* v. *Commissioner*, 35 B. T. A. 646; *Frederick L. Leckie* v. *Commissioner*, 37 B. T. A. 252; *Lilienthal* v. *Commissioner*, 80 F. (2d) 411; *Burnham* v. *Commissioner*, 86 F. (2d) 776; *Commissioner* v. *Kitselman*, 89 F. (2d) 458; *Commissioner* v. *Newberry Lumber and Chemical Co.*, 94 F. (2d) 447; *Commissioner* v. *Freund*, 98 F. (2d) 201; *Commissioner* v. *Tyng*, 106 F. (2d) 55. The law is well summarized by Justice Hand in the *Tyng* case as follows:

> "Five different Circuit Courts of Appeal, besides our own, and the Court of Claims as well, have decided that the receipt of 'securities' results in the retention of a continuity of interest necessary for a reorganization. We reached this conclusion in Watts v. Commissioner, 2 Cir., 75 F. (2d) 981, afterwards affirmed by the Supreme Court sub nomine Helvering v. Watts, supra. The following decisions are to the same effect: Scofield v. LeTulle, 5 Cir., 103 F. 2d. 20, 22; Commissioner v. Freund, 3 Cir., 98 F. 2d. 201, 205; Commissioner v. Newberry L. and C. Co., 6 Cir., 94

F. 2d. 447, 449; Commissioner v. Kitselman, 7 Cir. 89 F. 2d. 458, 460; Burnham v. Commissioner, 7 Cir., 86 F. 2d. 776; ceritorari denied 300 U. S. 683, 57 S. Ct. 753, 81 L. Ed. 886; Lilienthal v. Commissioner, 9 Cir., 80 F. 2d. 411, 413; White v. United States, Ct. Cls., 22 F. Supp. 821, 829."

Worcester Salt Co. v. *Commissioner*, 75 F. 2d 251, was decided prior to *Helvering* v. *Watts, supra*, and is not the law. *Pinellas Ice Co.* v. *Commissioner*, 287 U. S. 462 and *Cortland Specialty Co.* v. *Commissioner*, 60 F. 2d 937, involved short term notes which were held not to be securities.

CONCLUSION.

Petitioner respectfully prays that the judgment of the Circuit Court of Appeals be reversed and that of the District Court be affirmed and for such other relief as he may be entitled to.

Respectfully submitted,

W. E. Davant,
Homer L. Bruce,
Attorneys for Petitioner.